

Office of Chief Counsel
Internal Revenue Service

memorandum

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date: 6/13/00

to: Revenue Agent Joseph D. Medved
Internal Revenue Service
1175 Manheim Pike,
Lancaster, PA 17601

from: District Counsel, Pennsylvania District, Philadelphia

subject: [REDACTED]
Follow up request for legal advice

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In our memorandum dated April 21, 2000, we concluded that the taxpayer, a nonlife insurance company, could spread the reduction to its life insurance reserves resulting from a change in the method of calculating those reserves over the ten year period specified in I.R.C. § 807(f)(1). This memorandum follows up our April 21, 2000 memorandum by addressing whether the provisions of § 807(f)(1) also apply to reserve reductions resulting from a change in the taxpayer's method of calculating its non-life reserves.

ISSUE

Whether the taxpayer, a nonlife insurance company, may spread the reduction to its nonlife reserves over the ten year period specified in I.R.C. § 807(f)(1).

CONCLUSION

The provisions of I.R.C. § 807(f)(1) are inapplicable to nonlife reserves. A reduction in an insurance company's nonlife reserves is taken into income in the year of change through the mechanism provided by I.R.C. § 832(b)(4)(B).

FACTS

The taxpayer, a nonlife insurance company, changed its method of calculating its nonlife reserves. As a result, its nonlife reserves were lessened (or weakened).

DISCUSSION AND LEGAL ANALYSIS

Taxpayer argues that its nonlife reserves are unearned premium reserves under I.R.C. § 807(c)(2) and that, pursuant to I.R.C. § 816(c)(2), these reserves include unearned premium reserves of both its life and nonlife insurance business. While it is correct in stating that § 807(c)(2) does not differentiate between life and nonlife unearned premium reserves in this respect, its analysis ignore the fact that § 807, in general, applies to life insurance companies and that I.R.C. § 832, which defines insurance company income for nonlife insurers, differentiates between life and nonlife reserves.

§ 832 (b) provides that, in calculating insurance company taxable income under § 832(a), premium income is increased by 80% of the company's unearned premiums computed as of the end of the preceding taxable year and decrease by 80% of the company's unearned premiums on outstanding business at the end of the present taxable year. I.R.C. § 832(b)(4)(B). The amount of unearned premiums on life insurance reserves is not subject to this reduction. I.R.C. § 832(b)(7) provides that, with respect to life insurance reserves, premium income is increased or decreased, as the case may be, by 100% of the unearned life insurance premiums at the relevant time.

I.R.C. § 832(b)(4) further provides that, in the case of a non-life company, unearned premiums includes life insurance reserves "as defined in section 816(b) but determined as provided in section 807." Our memorandum of April 21, 2000 concluded that the full gamut of provisions relating to the determination of life insurance reserves, including the amortization provisions of I.R.C. § 807(f), applied to the life insurance reserves of non-life companies.

Here, the taxpayer seeks to extend the amortization provisions of § 807(f) to non-life policies on the ground that, under §§ 807((c)(2) and 816(c)(2), changes in unearned premiums included in total reserves, including unearned premiums and unpaid losses not included in life insurance reserves, are

specifically taken into account under § 807 and that, as a consequence, "there is no differentiation between the types of insurance business to which the unearned premium reserve relates." We disagree.

I.R.C. § 807 is found in Part I of Subchapter L, which deals with the income taxation of life insurance companies. As such, it does not differentiate between changes in unearned premiums with respect to life reserves and nonlife reserves. Moreover, as noted above, the provisions of § 807 are specifically made applicable to nonlife companies with respect to the determination of "life insurance reserves." Nothing in Part II of Subchapter L, which deals with the income taxation of property and casualty insurers, provides that nonlife reserves are to be determined as provided under I.R.C. § 807. And, as noted above, § 832(b)(4) and (7) specifically differentiate between the treatment of unearned premiums as they related to life and nonlife policies.

We conclude that the taxpayer may not amortize the increase to gross income resulting from a change in its method for calculating its unearned premium reserves for non-life policies under I.R.C. § 807(f). Instead, the reduction in reserves resulting from the change should be netted against its unearned premiums for nonlife policies outstanding at the end of the taxable year, and 80% of the resulting amount deducted from gross income for the year of the change as required by I.R.C. § 832(b)(4)(B).

SUMMARY AND CONCLUSION

Changes to the unearned premium reserves of nonlife policies of nonlife companies resulting from a change in methodology may not be taken into account over the ten year period specified in I.R.C. § 807(f)(1).

This concludes our advice and recommendation. Please feel free to call Special Litigation Assistant Richard H. Gannon at 215-597-3442 with any additional questions you may have. We are forwarding a copy of this advices to the Assistant Regional Counsel (Tax Litigation) and to the Office of Assistant Chief Counsel (Field Service) (CC:DOM:FS) for mandatory ten day post review. To assure that our National Office has sufficient time to review our advice, please refrain from taking any action with

respect to this issue for a period of 15 days from the date of this memorandum.

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